TwentyFour Income Fund

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Market Commentary

Conditions in January made for a difficult opening month for markets, as the Fed's hawkish pivot became apparent and tensions flared between Russia and Ukraine.

The release of the Fed minutes at the beginning of the month showed a growing consensus that they would have to act firmly to deal with the threat of inflation. For example, the minutes referenced the likelihood of quantitative tightening later this year. Moreover, following the release of the minutes, many FOMC members were quoted as supporting four hikes this year, a level of hawkishness that surprised the market and reinforced the reality that hiking was imminent. This concern increased on news of 7% year-on-year US inflation and continued tightening of the US labour market, with the unemployment rate reported as 3.9%.

The Fed had its first meeting of the year in late January, and while the official statement seemed relatively neutral, Powell's press conference was more hawkish. He alluded to every Fed meeting this year being live due to inflation, which he described as prolonged rather than transitory. As a result, the market began to price in five hikes for 2022. The clear indication of higher rates and possible quantitative tightening led to a steep sell-off in stocks, especially in the Nasdaq, due to stretched valuations and a reduction in market liquidity. This weak sentiment also began to seep into credit markets towards the end of the month.

There was also some volatility in Italy during January as the presidential election occurred. Mario Draghi put his name forward for President, which led to fears that leaving his position as prime minister may cause a snap election, given his reputation as a unifying figure. Eventually, the Italian electorate re-elected Sergio Mattarella as President, and Draghi remained as Prime Minister, avoiding any uncertainty.

Following a relatively quiet run into year-end the primary European ABS market enjoyed a very strong start to 2022. Over the course of the month nearly all of the issuance was in the RMBS market and, with the exception of two small Dutch and Irish deals, it was all UK RMBS. This brought placed supply in January across the whole market to just under €5bn, of which UK RMBS accounted for €3.8bn. Three Buy-to-Let deals and two Non-Conforming transactions from established and repeat issuers offered bonds across the capital stack and saw very strong levels of oversubscription, particularly in the mezzanine tranches, which in turn led to strong pricing execution inside the original initial price talk in all tranches across nearly all deals, despite some creative structuring in certain cases. However, it was the welcome return to the market by Nationwide Building Society, in the form of a Silverstone Prime RMBS deal that caught the eye. The lender's last RMBS deal priced almost two years ago and since then Prime RMBS issuance in general has been very sparse, and so this deal naturally saw very strong demand from investors starved of this type of simple, clean and robust collateral. The deal offered a $250m 1.97-year tranche and a £500m 4.93-year tranche, which were priced at SOFR +38 and Sonia +29 respectively, a few basis points inside the initial price guidance, and saw oversubscription levels of 6x in dollars and 2.1x in sterling. From a distribution perspective on the sterling tranche Bank Treasury investors accounted for 60%, followed by Asset Managers at 35% with 90% going into the UK. The dollar tranche was likely targeted mainly at US investors, many of whom have been long term supporters of this market going back to the global financial crisis, but that also saw 22% placed into the UK suggesting some investors were attracted by the relatively shorter maturity and a reasonably favourable spread on a cross-currency basis. The banks have been absent as issuers due to the availability of swathes of central bank funding provided to them as part of the government's pandemic support schemes. Despite a slight extension in the Weighted Average Life of many RMBS deals over the last nine months or so, which is in line with consumer preference to lock into longer five-year fixed rate mortgages, the fact that all these deals priced so strongly, despite a relatively flat curve between 3-5 years, endorses the strong supply-demand technical which remains in place for the ABS market. In any other year this level of primary issuance may have led to some softening in spreads as issuers as rediscovered their clearing levels, particularly in AAA.

Separately, an Irish CMBS deal backed by a granular portfolio of mortgages secured against small value commercial real estate became the first deal of the year in the sector and was comfortably placed with investors. All the loans were newly originated in this issuer's second transaction and offered some interesting diversification by geography and collateral. Despite a strong start in the UK, European originated issuance in consumer and auto ABS deals are thus far conspicuous by their absence. Equally, for the first time in five years the CLO market saw zero issuance in primary with just three managers completing €2.5bn of refinancing deals over the month.

With primary markets taking centre stage secondary trading was fairly muted for most of the mont, though it picked up after the first wave of deals were absorbed. New issue spreads rallied in the first two weeks with seniors around 5-10bp tighter and mezzanine bonds moving 20-25bp, though the market did see a little retracement as the month-end approached and the volatility seen in wider markets ultimately spilled into the securitised space. CLOs also saw a decent rally in the absence of primary supply as there was fairly consistent two-way trading over the course of the month. In line with other markets, some spread retracement was seen into month-end but this was mainly in the BB-B rated bonds.

Portfolio Commentary

The new issue supply enabled the portfolio managers to add several new positions during the month. The fund invested in the lower mezzanine tranche of a UK BTL deal at an attractive yield with slightly higher credit duration. In the secondary market the portfolio managers were able to source some rare mezzanine and sub-investment grade UK non-conforming bonds off an auction, adding to an existing holding at an attractive yield. Further additions were made in BB rated UK BTL and NC RMBS, together with CLOs in BB and B rated tranches from preferred managers which added some duration to the fund. Purchases were funded from shorter maturity holdings trading at cash premiums. Secondary market liquidity remained good throughout the month as dealers looked to top up depleted inventory levels after year-end balance sheet positioning. Performance fundamentals in the underlying portfolios remain strong, with positive rating actions observed over the month by rating agencies. The portfolio managers will continue to maintain high levels of due diligence on the underlying portfolio.

The fund returned 0.46% for the month with three year annualised monthly volatility at 11.29%.

Market Outlook and Strategy

The market got off to a strong start this year in the UK RMBS sector and we now expect primary issuance to pick up in other sectors, including CLOs, over the course of the next few weeks. The supply-demand technical remains in force as evidenced by the healthy oversubscription levels and strong pricing execution achieved by the stronger issuers through the month. Spreads retraced a little, mainly in AAAs and due in part to a slightly weaker market as volatility spilled into ABS, but also because of slightly weaker collateral in one or two later deals where clearing levels should understandably be wider.

Rolling Performance	31/01/2022 - 31/01/2021	31/01/2020 - 31/01/2021	31/01/2019 - 31/01/2010	31/01/2018 - 31/01/2019	31/01/2017 - 31/012018
NAV per share inc. dividends	6.94%	5.28%	7.44%	0.52%	12.85%

The performance figures shown are in GBP on a mid-to-mid basis inclusive of net reinvested income and, with the exception of share price performance figures, net of all fund expenses. Past performance is not a reliable indicator of future performance. Performance data does not take into account any commissions and costs charged when shares of the portfolio are purchased and disposed of.

Key Risks

- **All financial investment involves risk. The value of your investment isn't guaranteed, and its value and income will rise and fall. Investors may not get back the full amount invested.**
- Past performance is not a reliable indicator of future performance, and the Fund may not achieve its investment objective.
- The Fund invests in structured credit products or asset-backed securities (ABS). The issuer of such products may not receive the full amounts owed to them by underlying borrowers, which would affect the value of the Fund. Credit and prepayment risks also vary by tranche which may affect the Fund's performance.
- The Fund has the ability to use derivatives, including but not limited to FX forwards, for hedging only (EPM). This may magnify gains or losses.
- Typically, sub-investment grade securities will have a higher risk of issuer default, and are generally considered to be more illiquid than investment grade securities.

Fund Managers

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Further information on fund charges and costs are included on our website at www.twentyfouram.com